



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
J. J. SCHUMACHER }

Appearances:

For Appellant: James C. Sheppard, Attorney at Law

For Respondent: Harrison Harkins, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Chapter 329, Statutes of 1935, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of J. J. Schumacher to a proposed assessment of additional tax for the year ended December 31, 1935, in the amount of \$233.87.

The proposed assessment resulted from the Commissioner's disallowance of a deduction for a worthless debt claimed by the Appellant in the sum of \$10,864.88. The deduction was disallowed on the ground that the debt was ascertained to be worthless in 1933, and therefore was not a proper deduction for the year 1935.

It appears that in 1935 the Appellant purchased stock of the Vitamin Milling Company through one E. M. Allison, a broker who was financially interested in the corporation. On December 1, 1931, the Appellant commenced an action in the Superior Court of Los Angeles County against both Allison and the Vitamin Milling Company to recover from the defendants the amount paid for the stock, on the grounds that fraudulent representations had been made at the time of sale, and that the sale was void because no permit to issue or sell stock in California had been obtained.

After protracted litigation, strenuously defended at every stage, judgment was entered for plaintiff on March 21, 1935, in the sum of \$21,729.76. In an attempt to enforce collection of the judgment a writ of execution was caused to be issued, but was returned unsatisfied. Supplementary examination of the judgment debtors was had in July, 1935, and later during the same year, but no assets were uncovered. The Appellant and his wife, Miriam Schumacher, each deducted one-half the amount of the judgment as a worthless debt in their returns for the taxable year ended December 31, 1935.

The taxpayer bases his appeal on two grounds:

- (1) There was no debt until judgment was entered in 1935;
- (2) Even assuming that the debt existed prior to that time,

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there was no ascertainment of worthlessness by the taxpayer until efforts to collect the judgment in 1935 proved fruitless.

In view of the conclusion we have reached on the second point, it will be unnecessary to discuss the first.

Although a taxpayer will not be allowed a deduction for a worthless debt if in a previous year he had no reasonable ground for believing it to be of any value (Avery v. Commissioner, 22 F. 2d 6, the statute does permit him, in determining the fact of worthlessness, to exercise his discretion, provided he does so fairly and honestly. Person Construction Co. v. Commissioner, 116 F. 2d 94; Sabath v. Commissioner, 100 F. 2d 569, 571. he has a reasonable expectation that the debt, or any part of it, may be paid, he is under no duty to charge it off. Commissioner v. MacDonald Engineering Co., 102 F. 2d 942; Appeal of Wakefield Building, Inc., Board of Equalization, July 7, 1942. Moreover, it has been specifically held that the deduction of a debt as worthless is not precluded merely because in a previous year the individuals obligated were without recoverable assets. Sabath v. Commissioner, supra.

In view of these considerations and the facts presented by the record, we are of the opinion that the debt was properly deducted in 1935, and that the Commissioner erred in deciding to the contrary. If the Appellant has ascertained in 1933 that the defendants in the action were judgment proof, as contended by the Commissioner, it seems clear to us that he would not have proceeded further with the litigation, which no doubt entailed considerable expense to him. It appears that in 1933 he inquired of the Federal income tax authorities whether a deduction could be taken in that year on account of his transaction with Allison, and was advised that no deduction was allowable. This circumstance alone seems sufficient to preclude the contention that he acted unreasonably in claiming the deduction in 1935, when supplementary proceedings failed to result in the collection of any part of the judgment obtained in that year.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of J. J. Schumacher to a proposed assessment of additional tax in the amount of \$233.87 for the year ended December 31, 1935, be and the same is hereby reversed. Said ruling is hereby set aside and the said Commissioner is hereby directed to proceed in conformity with this order.

Done at Sacramento, California, this 4th day of August, 1942, by the State Board of Equalization,-

R. E. Collins, Chairman

Wm. G. Bonelli, Member

George R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary